
Public Chapter 357: A law to conform Tennessee's Sales and Use Tax Laws to the Streamlined Sales and Use Tax Agreement

Questions and Answers:

1Q: What is the Streamlined Sales and Use Tax Project?

1A: The Streamlined Sales Tax Project is a three-plus-year effort by Tennessee, 38 other states, local governments and many businesses to develop more simplified and uniform tax laws in all states so that business can more easily comply with sales and use tax requirements. The Streamlined Sales Tax Project and Streamlined Sales Tax Implementing States conducted this analysis with a view of determining what makes the retailer's role in administration and collection of sales taxes so expensive and difficult. The project culminated in the Streamlined Sales and Use Tax Agreement (SSUTA). The SSUTA developed nearly 30 requirements for adoption by participating states. When states incorporate these requirements, their sales tax systems will be more uniform, simpler, and less expensive to administer and retailer's sales tax collection costs and difficulties will be reduced.

The Agreement provides a way to address the uneven playing field that exists between local merchants and remote merchants with regard to sales tax collection requirements. The Agreement also provides a way to address the loss of revenues that governments are experiencing as a result of the growth of electronic commerce.

2Q: When does the Streamlined Sales and Use Tax Legislation become effective?

2A: Tennessee's law changes have an effective date that is contingent on the effective date of the Streamlined Sales and Use Tax Agreement. Based on what is happening at the national level and on the language in the Tennessee statute, the earliest possible date that Tennessee's law changes will take effect is July 1, 2005, except for the provisions related to the single article cap limitations. Until January 1, 2006, single article cap limitations will remain the same under the Streamlined legislation. Effective January 1, 2006, the Streamlined legislation will remove single article cap limitations except in the case of sales of cars, boats, planes, and mobile or manufactured homes. The Department will provide more information regarding the single article limitation for local option tax closer to that time.

3Q: How many states have adopted Streamlined Sales and Use Tax Statutes?

3A: As of now, 20 states have passed statutes intended to conform their laws to Streamlined provisions. Additional states have partially conformed their laws to the Streamlined provisions. Each state that is a Streamlined state will be represented on the Governing Board, which will administer the Agreement and will vote on whether each state's laws are in compliance with the Agreement.

4Q: How will Streamlined Sales Tax affect Tennessee?

4A: In order to make it possible for Tennessee to become a SSUTA member state, our legislature had to make numerous changes to Tennessee's sales and use tax laws. The legislature did this by enacting Chapter 357 of the Public Acts of 2003. Some of the changes had to be made in order for Tennessee to initially qualify as a Streamlined state. Other changes made are necessary for Tennessee to be a participating state, but do not have to go into effect until a later time. Many changes made by Tennessee's Streamlined legislation simply shift provisions of the existing sales tax law to a privilege tax to preserve existing tax rates and exemption provisions.

5Q: What is the biggest change under Streamlined Sales Tax?

5A: The most fundamental change under Streamlined Sales Tax is how we determine which state and local jurisdiction has the right to tax a transaction. Determining which jurisdiction has the right to tax is called “sourcing.” Under Streamlined, Tennessee will determine which jurisdiction has the right to tax a transaction based upon destination or receipt by the purchaser.

Example:

Customer orders tangible personal property from a Tennessee dealer. The tangible personal property is shipped to the customer in another state.

Old Law

Tennessee tax applies if title to goods passed in Tennessee

To determine where titles passes Tennessee has looked to whether goods were delivered by the seller or by common carrier, who arranged shipping, and what the shipping documents say regarding passage of title

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No Tennessee tax due; other state's tax law applies regardless of any indication of title or risk of loss passing in Tennessee

Note that the sale is sourced to the state and local jurisdiction in which the customer receives the product regardless of how the product is delivered and who delivers it.

Under Streamlined Sales Tax, receipt by a shipper never determines the location of a sale.

The vast majority of sales are over-the-counter sales, and there will be no change to the sourcing of over-the-counter sales.

6Q: Is this a new tax?

6A: No. It is important to remember that Streamlined Sales Tax is not a new tax. It is a way to make sales tax simpler and more uniform. By making each of the states laws simpler and more uniform, states hope to collect tax that has been part of our laws for nearly 50 years. Consumers owe this today but generally do not pay this tax.

7Q: How does Streamlined make it easier to comply with the tax laws?

7A: There are several ways in which Streamlined is designed to simplify compliance. These include:

- **Uniform definitions within tax laws:** Streamlined provides for definitions of terms that are common in sales tax laws across the country.

Please note that state legislatures still choose what is taxable or exempt in their state. However, a Streamlined State must agree to use the common definitions for key items. The Tennessee Streamlined legislation provides for us to make uniform definitions in our law as to those in the Streamlined agreement. In doing this, we have tried to mirror the existing tax base and tax exemptions that are in our law currently.

- **State level tax administration of all state and local sales and use taxes:** Local governments can no longer require businesses to file sales and use tax returns with each local government within which it conducts business in a state. Each state will provide a central point of administration for all state and local sales and use taxes and the distribution of the local taxes to the local governments. **Tennessee has this in our law now - it is not a change for us.** Sales and use tax returns for state and local tax are currently filed by specific location with the Department of Revenue.
- **A state and its local governments must use common tax bases:** If something is taxable for state tax purposes, it must also be subject to local tax - or if it is exempt from state tax, it must also be exempt from local tax. We have six different tax base issues that are addressed in the legislation that are required for Tennessee to be a Streamlined State. They are:

Cable television charges from \$15.01 - \$27.50 are exempt from local tax

Interstate telecommunications for business use are exempt from local tax

Energy fuels are exempt from local tax

Aviation fuels are exempt from local tax

Steam and chilled water purchased from a resource recovery facility is exempt from local tax

Materials of nonprofit colleges/universities used by contractors are exempt from state tax

Each of these has been addressed under Public Chapter 357 in order for Tennessee to be Streamlined State.

- **Tax rate simplification:** States are allowed one state rate and a second state rate in limited circumstances (on food and drugs, and certain energy fuels delivered by the seller). Each local jurisdiction is allowed one local rate.

We have 8 different state rate and 5 different local rate issues that are dealt with as part of the Streamlined legislation. Some rate issues are dealt with in the legislation by removing certain items from the sales tax base and imposing a privilege tax at the same rate. **This mechanism is allowed under Streamlined only if it does not increase the complications a seller faces in collecting and reporting sales tax.**

State Tax Rate Issues

Cable television charges from \$15.01 - \$27.50 are subject to an 8.25% state tax rate

Satellite television services are subject to an 8.25% state tax rate

Tangible Personal Property purchased by common carriers for use out of state is subject to a 3.75% state tax rate

Interstate telecommunications services for business are subject to a 7.5% state tax rate

Manufacturers' purchases of water are subject to a 1% state tax rate

Manufacturers' purchases of energy fuels are subject to a 1.5% state tax rate

Electricity and liquefied gas purchased by farmers/nurserymen are subject to a 1.5% state tax rate

Aviation fuel is subject to a 4.5% state tax rate

Each of these state rate issues has been addressed by Public Chapter 357 in order for Tennessee to be a Streamlined state.

Tennessee's different state rate for food is allowed under the SSUTA.

Local Tax Rate Issues

Tangible Personal Property purchased by common carriers for use out of state is subject to a 1.5% local tax rate

Intrastate telecommunication services for residential use are subject to a 2.5% local tax rate

Interstate telecommunication services for residential use are subject to a 1.5% local tax rate

Manufacturers' purchases of water are subject to a .5% local tax rate

Sales by dealers with no locations in Tennessee can use a 2.25% local tax rate

Each of these local rate issues has been addressed by Public Chapter 357 in order for Tennessee to be a Streamlined state.

- **Removal of caps and thresholds:** States must remove caps and thresholds on items to be a Streamlined state.

Caps are either "dollar caps" or "rate caps." The best known Tennessee cap is the local option cap on single articles of tangible personal property which must be removed on

items other than cars, boats, planes, and mobile or manufactured homes no later than 12/31/05.

We also have 6 different threshold areas that are dealt with as part of the Streamlined legislation. A threshold is where a certain amount of the purchase price of an item is excluded from tax. They are:

Machinery used to remanufacture industrial machinery that costs more than \$1,000 is exempt from tax

Cable Television charges from \$0 - \$15.00 is exempt from tax

Farm machinery exceeding \$250 is exempt from tax

15% of animal grooming & bathing is exempt from tax

\$150 of annual dues for memberships to recreation clubs is exempt from tax

The first \$500 of the sales price of caskets, burial vaults and urns is exempt from tax.

Each of these cap and threshold issues has been addressed by Public Chapter 357 in order for Tennessee to be a Streamlined state.

- **State and local governments must accept responsibility for notice of rate and boundary changes at restricted times:** The SSUTA provides that rate and boundary changes will be effective only on the first day of a calendar quarter after a minimum of sixty days notice to sellers. The Tennessee Streamlined legislation provides for this.
- **Uniform sourcing rules:** Under Streamlined, the states must have uniform and simple rules for how they will source transactions to state and local governments.

Sourcing is the term used to describe which state and local jurisdiction has the right to tax a transaction. The uniform rules will be based on the destination/delivery or receipt by the purchaser and will be the same rules for tangible personal property and services. This will be a change for Tennessee because we have been in the minority of states in sourcing in-state transactions to the origin of the sale or the business location of the seller. There is no change to the sourcing of over-the-counter sales in Tennessee.

- **Simplified exemption administration for use- and entity-based exemptions:** Sellers are relieved of the “good faith” requirements that exist in current law and will not be liable for uncollected tax on sales where an exemption is claimed. The purchasers will be responsible for paying the tax, interest and penalties for claiming incorrect exemptions. However, if sellers accept incomplete certificate of exemptions and do not maintain exempt sales information, sellers will be held liable.
- **The Streamlined Sales Tax System will provide sellers the opportunity to use one of three technology models for collection of sales tax:** A seller may use Model 1 where a Certified Service Provider, compensated by the states, will perform all of the seller’s sales tax functions. A seller may use Model 2, a Certified Automated System, to perform only the tax calculation function. A larger seller with nationwide sales that has developed its own proprietary sales tax software may use Model 3 and have its own

system certified by the states collectively. However, some sellers may choose to continue to use their current systems and still enjoy the benefits of Streamlined simplifications.

8Q: Will the Sales and Use Tax rate change for cable television services under Streamlined Sales Tax?

8A: Yes. Currently, Tennessee law exempts charges for cable television services below \$15. Charges for cable television services between \$15 and \$27.50 are subject to a state tax rate of 8.25% only and are not subject to local taxation. Charges for cable television services above \$27.50 are subject to state rate of 7% and the applicable local rate. Under the Streamlined sales and use tax legislation, cable television service will be exempt from state and local sales and use tax. Services sold by a qualified cable television provider or wireless cable television provider are subject to a 9% privilege tax with the first \$15.00 of the charge for the television service being exempt from the tax.

9Q: Will the Sales and Use Tax rate change for satellite television services under Streamlined Sales Tax?

9A: Yes. Currently, all charges of satellite television services are taxed at a state rate of 8.25% and are not subject to local taxation. Federal law prohibits local taxation of satellite television services. Under the Streamlined sales and use tax legislation, satellite television services are exempt from state and local sales and use tax. Services sold by a direct-to-home satellite provider are subject to a privilege tax of 8.25%. This is not a tax rate change. It is removed from the sales tax base and subject to a privilege tax. As stated above, federal law prohibits local taxation of satellite television services.

10Q: How are residential (non-business) interstate telecommunication services taxed under Streamlined Sales Tax?

10A: Interstate telecommunication services sold to customers that are not businesses are currently subject to a reduced local tax rate of 1.5% in all localities. The regular 7% state tax rate applies. Under the Streamlined sales and use tax legislation, interstate telecommunication services sold on a call-by-call basis are now sourced to (i) each level of taxing jurisdiction where the call originates and terminates in that jurisdiction or (ii) each level of taxing jurisdiction where the call either originates or terminates and in which the service address is located. "Call-by-call basis" means any method of charging for telecommunications services where the price is measured by individual calls. Thus, such services are subject to the applicable local tax rate in the taxing jurisdiction to which the call is sourced. The regular state tax rate of 7% still applies.

11Q: How are business interstate telecommunication services taxed under Streamlined Sales Tax?

11A: These services are currently subject to a 7.5% state sales tax and are not subject to a local sales tax. Under the Streamlined sales and use tax legislation, interstate telecommunication services are taxed at the state rate of 7% and at the applicable local tax rate.

12Q: How are intrastate telecommunication services taxed under Streamlined Sales Tax?

12A: These services are currently subject to a state tax rate of 7% and a local tax rate of 2.5% in all localities. Under the Streamlined sales and use tax legislation, intrastate telecommunication services are taxed at a state tax rate of 7% and at the applicable local rate.

13Q: How are energy fuels sold to manufacturers taxed under Streamlined Sales Tax?

13A: Currently, a state tax rate of 1.5% is levied on the sale or use of gas, electricity, fuel oil, coal and other energy fuels when sold to or used by manufacturers. These fuels are fully exempt if they come in direct contact with the product being manufactured. Such sales are exempt from local tax. Under the Streamlined sales and use tax legislation, the sale or use of gas, electricity, fuel oil, and coal and other energy fuels, when sold to or used by manufacturers, is fully exempt from state and local sales and use tax. However, the Streamlined legislation levies a privilege tax on such purchases or use by manufacturers at the same 1.5% state tax rate to preserve revenue neutrality. Manufacturers will report and pay the privilege tax to the Department of Revenue. Such fuels are exempt from the privilege tax when exclusively used in the manufacturing process coming into direct contact with the article being fabricated or processed by the manufacturer and being expended in the course of such contact. Energy fuel used by a manufacturer in fabricating or processing tangible personal property for resale is exempt from the privilege tax when produced or extracted directly by the manufacturer from facilities owned by the manufacturer or in the public domain. Electricity used to generate radiant heat for production of heat-treated glass sold to or used by manufacturers is exempt from the special user privilege tax.

14Q: How is water sold to manufacturers taxed under Streamlined Sales Tax?

14A: Water sold to manufacturers is currently subject to a 1% state rate. Water is completely exempt when coming into direct contact with the article being fabricated or processed by the manufacturer and being expended in the course of such contact. There are two different local rates on water sold to manufacturers. A rate of 1/3 of 1% applies whenever the general local tax rate does not exceed 1% and a rate of 1/2 of 1% applies whenever the general local tax rate exceeds 1%. Under the Streamlined sales and use tax legislation, water sold to or used by manufacturers is exempt from state and local sales and use taxes. However, the Streamlined legislation levies a privilege tax of 1.5% on the purchase price of water sold to or used by manufacturers. Water used by a manufacturer in fabricating or processing tangible personal property for resale is exempt from the privilege tax when produced or extracted directly by the manufacturer from facilities owned by the manufacturer or in the public domain. Water coming into direct contact with the article being fabricated or

processed by the manufacturer and being expended in the course of such contact is exempt from the privilege tax. Manufacturers will report and pay the privilege tax to the Department of Revenue.

15Q: Will the Sales and Use Tax rate change on energy fuels for nurseries and greenhouses?

15A: Yes. Currently, Tennessee levies a state tax rate of 1.5% on sales of electricity and liquefied gas when sold to farmers and nurserymen for use in production of food or fiber for human or animal consumption or to aid in the growing of a horticultural product for sale. Such sales are exempt from local tax. Under the Streamlined sales and use tax legislation, sales of electricity and liquefied gas are exempt from both state and local sales tax when sold to farmers and nurserymen for use in production of food or fiber for human or animal consumption or to aid in the growing of horticultural products for sales to farmers and nurserymen. Farmers and nurserymen must register to receive an exemption certificate from the Department of Revenue to make such purchases exempt from tax.

16Q: How are sales in Tennessee to common carriers for export and use outside of Tennessee taxed under Streamlined Sales Tax?

16A: Sales made in Tennessee to common carriers for goods that are to be exported and used outside our state are currently taxed at a state tax rate of 3.75% and a local tax rate of 1.5%. Under the Streamlined sales and use tax legislation, goods sold to common carriers for export outside Tennessee are exempt from state and local sales and use tax provided proper records are kept. However, a 5.25% privilege tax is levied on such purchases. Common carriers will report and pay the privilege tax to the Department of Revenue.

17Q: How are materials owned by nonprofit colleges or universities taxed under Streamlined Sales Tax?

17A: Currently, Tennessee law exempts materials owned by a nonprofit college or university from state sales and use tax when they are used by a contractor in the performance of a contract with the nonprofit college or university. The exemption is for state tax only and is subject to the applicable local tax rate. Under the Streamlined sales and use tax legislation, materials owned by a nonprofit college or university that are used by a contractor in the performance of a contract with the nonprofit college or university are exempt from both state and local sales and use taxes.

18Q: How are aviation fuels taxed under Streamlined Sales Tax?

18A: A state sales tax rate of 4.5% currently applies to the use, consumption, distribution and storage of aviation fuel that is used in the operation of aircraft motors. The Department has interpreted T.C.A. Section 67-6-704 as exempting such fuel from local taxation. Under the Streamlined sales and use tax legislation, the full 7% state tax rate and applicable local tax rate applies to the sale of aviation fuel. An exemption is available for qualified commercial air carriers. The Streamlined sales and use tax legislation also levies a 4.5% privilege tax

(calculated exclusive of federal excise tax paid by the producer or purchaser of such fuel) on the sale of aviation fuel used by commercial air carriers in the operation of aircraft motors. An exemption is available for sale of aviation fuel to be used by air common carriers for consumption, shipment, or storage in the conduct of business as an air common carrier for a flight destined for or continuing from a location outside the United States. Commercial air carriers will report and pay the privilege tax to the Department of Revenue.

19Q: How are fuels sold to common carriers for use in the operation of locomotives or railroads taxed under Streamlined Sales Tax?

19A: Currently, the sale or use of diesel fuel sold to common carriers for use in the operation of locomotives or railcars is the sale of tangible personal property currently subject to the full state sales and use tax rate of 7%. The Department has interpreted T.C.A. Section 67-6-704 to exempt such sales from local taxation. Under the Streamlined sales and use tax legislation, the sale or use of diesel fuel sold to common carriers for use in the operation of locomotives or railcars for the carriage of persons or property in interstate commerce is removed from the sales tax base. However, such diesel fuel is subject to a privilege tax of 6% on the purchase price sold to or used by a common carrier when used in the operation of locomotives or railcars for the carriage of persons or property in interstate commerce. Common carriers will report and pay the privilege tax to the Department of Revenue.

20Q: How is dyed diesel fuel sold for off-road use taxed under Streamlined Sales Tax?

20A: The sale of dyed diesel fuel is the sale of tangible personal property currently subject to the full state sales and use tax rate of 7%. The Department has interpreted T.C.A. Section 67-6-704 as exempting such fuel from local taxation. Diesel fuel used for agricultural purposes is exempt from sales and use tax. Under the Streamlined sales and use tax legislation, dyed diesel fuel purchased for off-road use is removed from the sales tax base and is subject to a privilege tax of 7% on the retail sale of dyed diesel fuel. Diesel fuel used for agricultural purposes is still exempt from sales and use tax.

21Q: How are vending machine sales taxed under Streamlined Sales Tax?

21A: Currently, the sale of tangible personal property by means of a vending machine or device is subject to Tennessee state and local sales taxes. Under the Streamlined sales and use tax legislation, taxation of sales of tangible personal property by means of a vending machine or device will remain unchanged. Please note that the legislature enacted T.C.A. Section 67-4-506, which provides that operators of machines that vend merchandise for 25 cents or less and operated for the benefit of a charitable nonprofit organization have the option of paying, in lieu of the sales tax, a gross receipts tax at the rate of 1.5%. For this purpose only, a vending machine is defined as a machine unable to make change and built so that only a fixed, predetermined price can be charged for the item dispensed.

22Q: How is the single article cap taxed under Streamlined Sales Tax?

22A: Tennessee law currently limits application of the applicable local option sales and use tax rate to the first \$1,600 on the sales or use of any single article of tangible personal property. A state tax rate of 2.75% applies to the next \$1,600 of the single article. Under the Streamlined sales tax and use tax legislation, single article cap limitations will remain the same until January 1, 2006. Effective January 1, 2006, the single article cap limitations will be removed except in the case of sales of motor vehicles, aircraft, watercraft, modular homes, manufactured homes or mobile homes. The Department will provide additional information on the single article cap removal, as well as certain refund and credit provisions contained in Public Chapter 357 closer to that time.

23Q: How is farm machinery and equipment taxed under Streamlined Sales Tax?

23A: Currently, Tennessee law exempts the purchase and repair of farm equipment and machinery from sales and use tax. "Farm equipment and machinery" is defined as a single article exceeding \$250 in price. Under the Streamlined sales and use tax legislation, the \$250 threshold is removed on sales of farm equipment to qualified farmers. It also requires farmers and nurserymen to register with the Department of Revenue and receive an exemption certificate to make farm-related purchases exempt from tax. These exemption certificates must be given to suppliers when making purchases.

24Q: How is the remanufacturing of industrial machinery taxed under Streamlined Sales Tax?

24A: Tennessee law currently exempts the purchase and repair of industrial machinery. Machinery costing in excess of \$1,000 that is necessary to and primarily for remanufacturing industrial machinery is included in the definition of "industrial machinery" and thus qualifies for the exemption. Under the Streamlined sales and use tax legislation, the \$1,000 threshold is removed so that all machinery necessary to and primarily for the remanufacturing industrial machinery is exempt from sales and use tax. "Remanufacturing" is defined as "making new or different products with new or different functions from the scrap materials used to make them."

25Q: How is animal grooming and bathing taxed under Streamlined Sales Tax?

25A: Currently, sales tax is applied to only 15% of the gross charge for animal grooming and bathing services. The bathing of animals for medical purposes by a veterinarian is exempt from the tax. Under the Streamlined sales and use tax legislation, the sales tax applies to a single combined charge for animal grooming and bathing. Where a separate charge is made for bathing from grooming, the sales tax applies only to the separate bathing charge. This does not affect the exemption available for veterinarians who are bathing animals as part of medical care.

26Q: How are club memberships taxed under Streamlined Sales Tax?

26A: Tennessee law currently exempts the first \$150 of annual dues for memberships to recreation clubs and community service organizations. Under the Streamlined sales and use tax legislation, the sales tax exemption for the first \$150 of annual dues for recreational club memberships is removed so that the total amount is subject to the state tax rate and applicable local tax rate. These provisions do not affect exemptions available for health and fitness club memberships or community service organization memberships that are currently fully exempt from sales tax.

27Q: How are caskets and burial vaults taxed under Streamlined Sales Tax?

27A: Currently, the first \$500 of the sales price of caskets and burial vaults is exempt from sales tax. Amounts above \$500 are fully taxed as sales of tangible personal property at the state rate and applicable local rate. Under the Streamlined sales and use tax legislation, the \$500 threshold exemption is removed so that the entire sales price of caskets, burial vaults, and urns is subject to the state tax rate and applicable local tax rate.